



Appeals of Leight Sales Co., Inc. and
G. L. Company, Inc.

These appeals have been consolidated for disposition because of appellants' common ownership and the presence of substantially identical facts and issues.

On their franchise tax returns for the income years ended June 30, 1972, 1973, 1974, and 1975, appellants deducted additions to their reserves for bad debts to increase the reserves to approximately .7 percent of sales on account. Apparently in late 1975, bad debt losses increased significantly, and appellants determined that their bad debt reserves were inadequate. Appellants subsequently filed amended California returns for each of the aforementioned years, claiming additional deductions for additions to their bad debt reserves consistent with a retroactive increase in those reserves equal to at least 2.8 percent of sales; appellants apparently filed amended federal returns on the same basis.

Upon audit, appellants furnished respondent with copies of final federal audit changes covering the referenced income years. The federal authorities had denied appellants' refund claims for the fiscal year ended June 30, 1972 because the statute of limitations had expired. Moreover, while making partial refunds for the remaining years based upon various adjustments, the federal authorities rejected appellants' claim that they were entitled to retroactively increase their bad debt reserves. Based upon the federal audit changes, respondent withdrew its proposed assessments for the income years ended June 30, 1973, 1974, and 1975 and granted refunds consistent with those audit changes. However, because appellants' claims for refund for the income year under appeal were based solely upon a claimed retroactive increase in their bad debt reserves, respondent denied those claims, thereby resulting in this appeal.

The sole question for determination is whether appellants may retroactively increase their reserves for bad debts.

Section 24348, subdivision (a), of the Revenue and Taxation Code allows a taxpayer to reflect its bad debts deduction by either of two mutually exclusive methods: (i) by the deduction of debts which become worthless within the income year; or (ii) in the discretion of respondent, by a reasonable addition to a reserve for bad debts; If the taxpayer elects the

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reserve method, the estimate of the bad debt reserve required for any year must be measured by conditions as they reasonably appear at the time the estimate is made. Where the taxpayer has charged the annual addition to its reserve for bad debts, and deducted that amount, it may not, in a subsequent year, retroactively deduct an additional amount reflecting an increase in its reserve. (See, e.g., Appeal of Hill Drive Rental Co., Inc., Cal. St. Bd. of Equal., Jan. 16, 1973; see also Cal. Admin. Code, tit. 18, reg. 24348(g), subd. (2)(B).) Appellants have cited no authority, nor are we aware of any, to support a different interpretation of the relevant statute.

For the reasons set forth above, we must conclude that respondent properly determined that appellants were not entitled to retroactively deduct additional amounts reflecting increases in their bad debt reserves. Respondent's action in this matter will therefore be sustained.

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ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and 'good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claims of Leight Sales Co., Inc. and G. L. Company, Inc. for refund of franchise tax in the amounts of \$4,298 and \$1,751, respectively, for the income year ended June 30, 1972, be and the same is hereby sustained.

Done at Sacramento, California, this 29th day
of June , 1982, by the State Board of Equalization,
with Board Members Mr. Bennett, Mr. Dronenburg and
Mr. Nevins present.

William M. Bennett , Chairman

Ernest J. Dronenburg, Jr. , Member

Richard Nevins, Member

_____, Member

_____, Member